BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

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Order Instituting Rulemaking to Address Utility Cost and Revenue Issues Associated with Greenhouse Gas Emissions.	)))	R.11-03-012 (Filed March 24, 2011)

REVISED JOINT PROPOSAL AND SUPPLEMENTAL INFORMATION OF PACIFIC GAS AND ELECTRIC COMPANY (U 39 E), SOUTHERN CALIFORNIA EDISON COMPANY (U 338-E), AND SAN DIEGO GAS & ELECTRIC COMPANY (U 902 M) ON THE APPROPRIATE USE OF ALLOWANCE AUCTION REVENUES

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JOINT PROPOSAL OF PACIFIC GAS AND ELECTRIC COMPANY (U 39 E), SOUTHERN CALIFORNIA EDISON COMPANY (U 338-E), AND SAN DIEGO GAS & ELECTRIC COMPANY (U 902 M) ON THE APPROPRIATE USE OF ALLOWANCE AUCTION REVENUES

TABLE OF CONTENTS

JOINT PROPOSAL OF PACIFIC GAS AND ELECTRIC COMPANY (U 39 E), SOUTHERN CALIFORNIA EDISON COMPANY (U 338-E), AND SAN DIEGO GAS & ELECTRIC COMPANY (U 902 M) ON THE APPROPRIATE USE OF ALLOWANCE AUCTION REVENUES

TABLE OF CONTENTS (CONTINUED)

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE

STATE OF CALIFORNIA

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Pursuant to Ordering Paragraph 5 of Assigned Commissioner and Administrative Law Judges' ("ALJs'") Joint Scoping Memo and Ruling in this *Order Instituting Rulemaking to Address Utility Cost and Revenue Issues Associated with Greenhouse Gas Emissions* ("GHG OIR"), dated September 1, 2011 (the "Ruling") and subsequent rulings, Pacific Gas and Electric Company ("PG&E"), Southern California Edison Company ("SCE"), and San Diego Gas & Electric Company ("SDG&E") (jointly, the "Joint IOUs") respectfully submit this proposal (the "Joint IOU Proposal").[1] As discussed in more detail below, the Joint IOUs propose that 100 percent of Assembly Bill ("AB") 32 allowance auction revenues be returned directly to utility customers in proportion to AB 32 costs incurred, because this is the most equitable and cost-effective method for ensuring that utility customers receive the full benefits of the allowances allocated to IOUs.

[1] Pursuant to Rule 1.8(d) of the Commission's Rules of Practice and Procedure, counsel for PG&E and SDG&E authorize counsel for SCE to file this pleading on their behalf.

The Joint IOUs previously submitted the Joint IOU Proposal on October 5, 2011 in this proceeding, and the revised proposal does not materially change the Joint IOUs' proposal that 100 percent of allowance auction revenues be returned directly to customers in proportion to the costs incurred by those customers. On November 1-2, 2011, the California Public Utilities Commission ("Commission") held a workshop (the "Workshop") to discuss the rate impact model and allowance revenue return proposals filed in this proceeding. At that Workshop, the Joint IOUs gave a presentation summarizing the Joint IOU Proposal and received useful feedback and requests for supplemental information from the ALJs and participating stakeholders. Also at the Workshop, ALJ Hecht and ALJ Semcer requested that the Joint IOUs provide supplemental information to respond to and reflect this feedback. Attached as Appendix D is a summary of the supplemental information provided to support the Joint IOU Proposal submitted on October 5, 2011, as reflected in this revised Joint IOU Proposal.

I.

INTRODUCTION AND EXECUTIVE SUMMARY

In this proceeding, the Commission must determine how to direct utilities to use the revenues received from sale of AB 32 greenhouse gas ("GHG") emissions allowances under the cap-and-trade program for the exclusive benefit of utility customers. This use must be consistent with the California Air Resources Board's ("ARB's") intended mitigation of allowance cost burdens in its cap-and-trade rulemaking and the authority of the Commission to establish fair and reasonable electricity rates. The allocation of the revenues generated from the sale of cap-and-trade allowances is of vital importance to the IOUs and their customers, as it enables the IOUs to address the significant costs borne by electricity customers that arise from all AB 32 emission reduction measures (including cap-and-trade as well as investments in renewable energy, energy efficiency and combined heat and power resources).[2] In this proceeding, the Commission has the

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2 In December 2008, pursuant to AB 32, the ARB adopted its Scoping Plan for AB 32 GHG emissions reduction measures. The Scoping Plan includes specific electric and gas utility compliance measures for the California

Continued on the next page

opportunity to support the goals of AB 32 and ensure that overall costs to customers associated with AB 32 are mitigated, by directing the Joint IOUs to return these allowance revenues directly back to utility customers in an equitable and cost-effective manner.

The Ruling invites interested stakeholders to propose methodologies for the appropriate use of the allowance revenues. The Ruling sets forth seven key policy objectives against which the various stakeholder proposals may be evaluated. Those policy objectives include:

1) Preserve the Carbon Price Signal;

2) Prevent Economic Leakage;

3) Distribute Revenues Equitably Recognizing the Public Asset Nature of the Atmospheric Carbon Sink;

4) Reduce Adverse Impacts on Low-Income Households;

5) Correct for Market Failures that Lead to Underinvestment in Carbon Mitigation Activities and Technologies;

6) Maintain Competitive Neutrality Across Load Serving Entities ("LSEs"); and

7) Achieve Administrative Simplicity and Understandability.

The Ruling also invites stakeholders to recommend additional policy objectives and to rank all of the policy objectives – both the Ruling objectives and the additional objectives – in order of importance.

The Joint IOUs propose two additional policy objectives:

1) Mitigate cost increases to IOU customers due to the cap-and-trade program and other AB 32 emissions reduction measures (such as the 33% Renewable Portfolio Standard ("RPS"), Customer Energy Efficiency ("CEE"), the California Solar Initiative ("CSI") and Combined Heat and Power ("CHP")) for <u>all</u> customers, including direct access ("DA"), community choice aggregator ("CCA") and low-income customers; and

2) Ensure an equitable return of allowance revenues to customers by adhering to equity principles of cost causation and specifically avoiding cross subsidies.

Continued from the previous page

Cap and Trade Program; Energy Efficiency; the Renewable Portfolio Standard; and the California Solar Initiative. *See* Scoping Plan at ES-3- ES-6; 17- 22; 27- 56; Appendices C and E.

As detailed below, the Joint IOUs have ranked these two new objectives as "Critical" because these objectives are not addressed by other elements of the AB 32 program, are expressly included in the AB 32 legislation, and are critical to public acceptance of the cap-and-trade program.

In addition, the Joint IOUs place great weight on the objectives of competitive neutrality across LSEs and mitigating economic leakage, because these objectives are explicitly promoted in the ARB regulations. They are also important in ensuring that the two critical objectives – cost mitigation and equity – are achieved. Similarly, administrative simplicity is important for keeping customer costs low as well as improving public perception of the cap-and-trade program. The Joint IOUs rank these policy objectives as "Very Important."

The Joint IOUs rank the other three objectives – preserve the carbon price signal, distribute revenues equitably recognizing the public asset nature of the atmospheric carbon sink, and correct for market failures that lead to underinvestment in GHG-reducing technologies – as "Not Necessary" because these policy objectives are already met by other elements of the cap-and-trade program or the Commission-adopted rate structures. For example, the cap-and-trade program already provides direct and effective price signals at the wholesale level, while the Commission's current rate design provides a more than sufficient retail-level price signal in customer rates. Any approach used to achieve a price signal at the total retail rate level on top of the wholesale price signal would only send a duplicative, burdensome, and arbitrary price signal.

In this Joint IOU Proposal, similar to the proposal contained in the Joint IOUs' Interim Motion[3] previously filed in this proceeding, the Joint IOUs propose that 100 percent of the AB 32 cap-and-trade allowance revenues be credited directly to retail electricity and gas customers approximately in proportion to the costs incurred by each customer related to various AB 32 programs. Pursuant to the ARB's intent, the Joint IOUs propose returning allowance revenues to customers to mitigate not only direct cap-and-trade compliance costs but all costs associated with

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3 Joint Motion of PG&E, SCE, and SDG&E for Interim Decision to Authorize Use of Greenhouse Gas Allowance values for 2012 Electricity Rates, R.11-03-012 (filed May 11, 2011).

meeting the GHG reduction targets mandated by AB 32. Since these AB 32 costs are substantially in excess of the value of allowances to be allocated to the IOUs under the cap-and-trade program, the Joint IOUs propose allocating 100% of the allowance revenue directly to customers. The Joint IOUs also propose a process for all stakeholders in this proceeding to collaborate on the development of a targeted customer education and outreach program to ensure that transparent and timely information is available to customers on the goals and benefits of the AB 32 cap-and-trade program and other emissions reduction measures.

The Joint IOUs' approach will mitigate rate increases that California customers experience under AB 32. It will also ensure that those customers who bear the costs of AB 32 receive their proportional share of the allowance revenues, thereby adhering to equity principles of cost-causation. This approach meets the additional objectives of being administratively simple to implement, promoting competitive neutrality across all LSEs and minimizing leakage. Thus, the Joint IOU Proposal helps ensure that the policy objectives most critical to the success of the AB 32 cap-and-trade program and other AB 32 emissions reduction measures will be fully realized and also helps ensure that AB 32 is perceived by customers as a success.

Below, the Joint IOUs describe each specific issue raised in the Ruling. Section II describes the Joint IOUs' additional policy objectives and discusses why and how each proposal submitted to the Commission should be evaluated against them. Section III provides a ranking of all of the policy objectives and includes an explanation of the Joint IOUs' ranking order. Section IV presents the Joint IOU Proposal. Section V discusses how the Joint IOU Proposal meets the various policy objectives. Finally, Section VI discusses jurisdictional issues and how the Joint IOU Proposal incorporates previous guidance from the Commission and the ARB.

II.

DESCRIPTION OF ADDITIONAL POLICY OBJECTIVES AND DISCUSSION OF HOW PROPOSALS SHOULD BE EVALUATED AGAINST THEM

As a threshold matter, the Joint IOUs recommend that two additional policy objectives be added to the list. First, it is essential that in evaluating the various proposals that the Commission consider the extent to which each proposal mitigates AB 32 costs and cost-effectively returns the benefits of AB 32 allowances to all customers, including DA and CCA customers. Likewise, the Commission should evaluate if, and to what extent, each proposal returns the allowance revenues to customers equitably and proportionally – in a manner that adheres to cost-causation principles established by the Commission in its ratemaking jurisprudence. Below, the Joint IOUs describe these additional policy objectives and discuss how the proposals submitted by various stakeholders in this proceeding should be measured against these objectives.

A. Additional Policy Objective #1: Provide Benefits and Mitigate Costs for All Customers and Ensure Cost-Effective Emissions Reductions Measures

The Commission must consider whether and to what extent each proposal mitigates AB 32 costs borne by customers. Additionally, the parties should be required to demonstrate that their proposals to fund any new or existing AB 32-related programs support the most cost-effective and efficient method of achieving emissions reductions and do not duplicate emissions reduction measures and programs already adopted under AB 32. The Commission must also consider the extent to which each proposal mitigates sudden rate increases, including rate increases that may not be offset due to delays in the return of allowance revenues to customers. To implement this objective, the Commission must not only consider the extent to which each proposal affects average rates, but also whether certain classes of customers, or even individual customers, experience sudden bill increases.

B. Additional Policy Objective #2: Return Allowance values to All Customers in a Manner Consistent with Equity Principles of Cost-Causation

Another policy objective that the Commission must consider is whether each proposal is equitable. The Joint IOUs define "equitable" as containing two components: allocation of costs based on cost-causation and avoidance of cross-subsidies. A cross-subsidy exists in a rate structure when one group of customers pays rates in excess of its respective cost responsibility, thereby subsidizing rates of another group whose rates fall below its cost of service. The Commission itself has held that the avoidance of cross-subsidies and reliance on cost-causation principles "achieves equity in rates by relating the costs imposed on the utility system to the customer responsible for those costs."[4]

In applying these principles, the Commission also must take into account that statutory mandates and other public purpose programs funded by utility rates in California have already imposed significant cross-subsidies. This is caused by the current tiered rate structure for residential customers in California and statutes that cap the amount by which the lower-tier customers' rates may increase. For example, although Senate Bill ("SB") 695 allows for a three to five percent increase in the rates of residential customers in the first two tiers, increase in utility costs brought about by public policy mandates has resulted in upper tier rates that are more than double the Tier 1 rates.[5] The result is that high-usage residential customers will bear almost all of the costs of the AB 32 program allocated to the residential rate class unless and until the statutory rate restrictions are lifted or modified. Accordingly, any proposal to allocate GHG allowance revenues to cross-subsidize certain customer groups over others, should be avoided or minimized in order to avoid exacerbating the cross-subsidies that already exist under the SB 695 statutory mandate, especially if the new cross-subsidies duplicate existing sources of funds for the same programs.

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4 *See* Decision No. 87-12-066, Application No. 86-12-047 (Filed December 26, 1986).

5 California Public Utilities Code §§ 739.1, 739.2 and 739.9.

III.

RANKING OF POLICY OBJECTIVES AND EXPLANATION OF RANKING

A. Ranking of Policy Objectives

The Joint IOUs rank the policy objectives (including the seven[6] Commission policy objectives and two additional policy objectives described in Section II) in the table below:

Rank	Policy Objective
Critical	➢ Mitigate cost increases for all customers and ensure cost-effectiveness of emissions reduction measures / Reduce adverse impacts on low income households ➢ Return revenues to customers in manner consistent with equity principles of cost-causation
Very Important	➢ Achieve administrative simplicity and understandability ➢ Maintain competitive neutrality across load serving entities ➢ Prevent economic leakage
Not Necessary (or Already Addressed in Other Objectives)	➢ Preserve the carbon price signal ➢ Distribute revenues equitably recognizing the "public asset" nature of the atmospheric carbon sink ➢ Correct for market failures that lead to ongoing underinvestment in GHG-reducing technologies

6 As mentioned above, the Joint IOUs have included the "reduce adverse impacts on low-income households" policy objective in the new, more broadly-focused "mitigate cost increases for all customers" objective.

B. Explanation of Joint IOUs' Ranking of Policy Objectives

1. Critical: Mitigate cost increases for all customers and ensure cost-effectiveness of emissions reduction measures/Reduce adverse impacts on low income households

One of the most important policy objectives is to ensure that the cap-and-trade program is implemented in a way that is cost-effective and does not result in sudden rate increases to any class of customers. This objective includes the Ruling policy objective of reducing adverse outcomes for low-income customers and also fulfills the objective of mitigating economic leakage, as it is critical to ensure that all customers are protected against significant and sudden rate increases resulting from the cap-and-trade program.

The reasons the Joint IOUs rank this policy objective as "Critical" are threefold. First, it is clear that this is what the Legislature and ARB intended. The text of AB 32 repeatedly calls for implementation of the cap-and-trade program in an efficient and cost-effective manner.[7] The statute references cost-effectiveness no less than ten times, mandating the adoption of rules and regulations that achieve cost-effective GHG emissions reductions,[8] requiring the ARB to consider cost-effectiveness of the regulations,[9] and requiring the ARB to meet with other state agencies, including the Commission, to ensure that GHG emissions-reduction activities can be implemented in an efficient and cost-effective manner.[10] Accordingly, to ignore cost-effectiveness in allocating allowance revenues to customers would undermine this fundamental purpose of the cap-and-trade program.

Similarly, it was the express intent of the Legislature in drafting AB 32 that ARB design emission-reduction measures in a manner that "minimizes costs and maximizes benefits for

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7 Cal. Health and Safety Code § 38560 *et seq.*
8 Cal. Health and Safety Code § 38560.
9 Cal. Health and Safety Code § 38562.
10 Cal. Health and Safety Code § 38561(a).

California's economy."[11] The stated purpose of the allowance allocation to utilities is "[t]o ensure that electricity ratepayers do not experience sudden increases in their electricity bills associated with the cap-and-trade regulation."[12] Additionally, in the ARB's Staff Proposal for Allocating Allowances to Electricity Distribution Utilities states, "[a] central principle of the allowance allocation to the electricity sector is the incorporation of customer cost burden."[13] ARB goes on to say that "[a]s a matter of policy the approach to allocating allowances to the electric sector has been to ensure that each utility's allocation is at least equal to their customers' total expected cost burden in each year."[14] Accordingly, the mitigation of costs to all customers is an essential addition to the current list of policy objectives.

Second, the ARB has repeatedly recognized that the cap-and-trade mechanism was selected over other command-and-control approaches because the cap-and-trade program is market-oriented, thereby allowing the State to utilize the lowest-cost methods for emissions reductions. For example, the ARB's Initial Statement of Reason ("ISOR") states that cap-and-trade "affords covered entities flexibility to seek out and implement the lowest-cost options to reduce emissions."[15] The ARB has consistently defended the cap-and-trade program against challenges on these grounds.[16]

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11 *See* Cal. Health and Safety Code § 38501(h).

12 *See* ARB Proposed Regulation to Implement the California Cap-and-Trade Program, Part I, Volume I, Staff Report: Initial Statement of Reasons ("ISOR") at II – 28. *See also,* Appendix J at J16 ("[ARB] staff is mindful of the need to protect ratepayers from increased expenditures on electricity. Therefore, distribution utilities will receive free allowances, and the value of the allowances must be used to mitigate the bill impacts of AB 32 programs on their distribution customers.").

13 *See* ARB Cap-and-Trade Regulation, July 2011 Proposed 15-Day Modifications: Appendix A: Staff Proposal for Allocating Allowances to Electricity Distribution Utilities at 5 (dated July 27, 2011), available at: http://www.arb.ca.gov/regact/2010/capandtrade10/candtappa2.pdf.

14 *Id.* at 11.

15 ISOR at ES-1.

16 *See* Supplement to the AB 32 Scoping Plan Functional Equivalent Document at 37 (dated June 13, 2011), available at: http://www.arb.ca.gov/cc/scopingplan/document/Supplement_to_SP_FED.pdf ("The intended advantage of a cap-and-trade program is that total GHG emissions decrease in compliance with a cap (i.e., allowable emission limit) that declines over time, while covered entities are afforded flexibility to pursue the most cost-effective actions to reduce emissions.").

Third, public acceptability of the cap-and-trade program will hinge on how it mitigates those customer costs associated with achieving all of AB 32's GHG emissions reduction goals. Given the current state of California's economy, customers simply will not tolerate significant rate increases. At the same time, customer rates already reflect significant GHG "premiums" as the result of other AB 32 emissions reduction measures, such as the RPS, CSI, existing CEE and conservation programs as well as necessary transmission and distribution infrastructure programs to accommodate intermittent renewable generation. There is a real risk that, upon seeing costs in excess of the significant GHG premium already included in rates for existing AB 32 measures, the public may perceive the overall AB 32 program as a failure, generally leading to resistance to future cap-and-trade programs or GHG-reduction programs in other jurisdictions even before those programs begin. On the other hand, if no customers experience extreme or sudden rate increases, the ARB's program can build broad public support for cap-and-trade programs in general and maintain support for California's AB 32-related programs in particular.

2. Critical: Return revenues to customers in manner consistent with equity principles of cost-causation

Another critically important policy objective is the *equitable* implementation of the cap-and-trade program. This is a requirement of AB 32.[17] The Joint IOUs have interpreted the term "equitable" to mean, *inter alia,* that the allowance revenues are returned in a way that promotes principles of cost causation and specifically the avoidance of cross-subsidies.[18] The Commission has articulated the importance of these equity principles in several decisions. For example, in establishing a methodology for allocating funds of the CSI program, the Commission sought, on equity grounds, to avoid cross-subsidization whereby "the majority of funds are collected from

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17 *See generally* Cal. Health and Safety Code § 38562(b)(1) (requiring the ARB to design cap-and-trade regulations in a manner that is equitable).

18 *See* D.06-04-050 ("Movement towards full [equal percent of marginal cost], tempered with limits where bill impacts become significant, provides a reasonable balance between equity and efficiency in ratesetting.").

residential customers but the majority of incentives are paid to non-residential customers."[19] Similarly, in a decision regarding implementation of real-time pricing, the Commission defined equity in terms of avoiding cross-subsidies both between classes and across generations.[20] In another decision, the Commission held that it is equitable that ratepayers who have received the brunt of rate increases receive the benefit of rate reductions resulting from tax revenue returns, whereas customers who did not experience the rate increase as the result of rate caps, should not.[21]

California cannot expect to garner broad public support for the cap-and-trade program and other AB 32 measures if the program creates or exacerbates inequities in current mandated electric rate designs. Given the importance of this policy objective to the success of the cap-and-trade program and given that the Commission has already articulated this as an important principle in the ratemaking context, the IOUs rank it as "Critical."

3. Very Important: Achieve administrative simplicity and understandability

Administrative simplicity directly translates into lower costs for customers. The IOUs will be responsible for ensuring that the allowance revenues are returned to customers in accordance with the rules established in this proceeding. The costs associated with implementing these rules will ultimately be borne by customers. Because administrative simplicity can reduce the overall costs that customers will bear, the IOUs have ranked this objective as "Very Important."

The return of allowance revenues to customers should be structured in a way that minimizes the costs of ensuring that those customers allocated funds under the Commission's

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19 *See* D.06-08-028, *In re California Solar Initiative,* 251 P.U.R.4th 128 Ca.P.U.C. at 49 (filed August 24, 2006).

20 *See* D.01-08-021, *In re Southern California Edison Co.*, 2001 WL 1359764 Ca.P.U.C. at 6 (filed August 02, 2001).

21 *See In re Article XIII A 1,* CPUC 2d 193 Cal.P.U.C., (dated February 27, 1979). *See also*, A.09-08-005, D,09.10.021, Decision Granting the Application of Pacific Gas and Electric Company for Electric Bill Credits Under the ERRA Trigger Mechanism (dated October 15, 2009) (holding that because "PG&E's CARE and Tier 1 and Tier 2 ratepayers did not pay the higher than actual costs," those ratepayers "should not receive a portion of the refund that is due those who did pay the higher costs.").

final decision will actually receive them. This process becomes more challenging if the return of allowance revenues occurs later than when the costs are incurred, as tracking down customers who have moved or gone out of business can be difficult and costly.

Likewise, further complicating already complicated rate design structures can easily result in customer confusion and frustration. For example, AB 32 rate increases that are not immediately and clearly offset by the return of allowance revenues create a risk that customers will not associate any GHG allowance revenue received with the associated costs. There may be substantial customer backlash if customers see the costs of implementing AB 32 programs before receiving the offsetting revenues. Accordingly, simplicity is important to ensuring customer comprehension, thus avoiding extensive and costly explanation or bill disputes.

4. Very Important: Maintain competitive neutrality across LSEs

The IOUs support maintaining competitive neutrality across all LSEs. The purpose of AB 32 was not to alter the relative competitive positions of the various LSEs and the Commission should seek to avoid such an unintended consequence. As explained above, ARB explicitly states that there should be equal treatment of IOU customers and customers of other LSEs. Accordingly, the IOUs rank this objective highly.

5. Very Important: Prevent economic leakage

In order to ensure the ultimate success of the cap-and-trade program in achieving GHG reductions, economic leakage should be mitigated. Specifically, proposals should be evaluated with a view toward mitigating the impact that the cap-and-trade program will have on emission intensive, trade exposed ("EITE") industries. The Joint IOUs recognize that if EITE customers move out of state due to increased costs, there will be no real global GHG reductions. In addition, any exodus is likely to put increased pressure on the rates of customers that remain in the State. Furthermore, given the state of the California economy, it is important to the success of the cap-and-trade program to avoid hindering economic growth or job creation. Accordingly, the Joint IOUs rank this policy objective highly.

6. Not Necessary: Preserve the carbon price signal

Sending an additional price signal for carbon through the return of allowance revenues is not a necessary objective of the cap-and-trade program for four basic reasons: first, an adequate conservation price signal for carbon already exists at the wholesale level; second, a more than adequate price signal already exists at the retail level by way of California's tiered residential rate structure and the impact of other GHG reduction measures on rates; third, any additional retail price signal would not be seen by all customers; and fourth, an additional retail-level price signal is not a cost-effective way to achieve emissions reductions.

As described below, the IOUs believe that an effective customer education and outreach campaign also will send a sufficient conservation message to customers and help make the overall AB 32 program successful.

a) The Cap-and-Trade Program Will Create a Direct Price Signal at the Wholesale Level, in Addition to Already Existing Commission GHG Reduction Policies that Create an Effective Carbon Price Signal

The most significant impact of the cap-and-trade program on the electricity sector will be an accurate wholesale (or supplier) level price signal. For instance, under cap-and-trade, owners of conventional, GHG-emitting generation will incorporate the cost of procuring allowances into their electricity costs, making such generation more expensive and less competitive in the market. In other words, the price of electricity will now include GHG costs, thereby sending a price signal to electricity buyers to purchase cleaner electricity and to sellers to reduce their emissions, if possible. It is at this wholesale level where electricity market participants make important short- and long-term decisions about what resources are most economical to dispatch. The GHG price signal will, in many cases, affect these dispatch decisions, leading electricity deliverers to choose to use cleaner generation sources. The GHG price signal is preserved in the most important segment of the electricity market.

Additionally, the Commission and the IOUs already directly incorporate an effective carbon price signal into IOUs' wholesale procurement through the "carbon adder" that the IOUs use in resource planning under their Long Term Procurement Plans ("LTPP"). This signal is also supported through the SB 1368 GHG "emissions performance standard" which prohibits the wholesale procurement of electricity from facilities with GHG emissions above a certain level.

b) <u>There is Already A More Than Sufficient Retail-Level Price Signal Embedded In California IOU Retail Electricity Rates</u>

The IOUs currently include the significant costs of AB 32 emissions reduction programs (such as CEE, CSI, RPS and SGIP), amounting to billions of dollars per year, in the rates of all customers except low usage residential and low-income customers.[22] The costs of these programs, which directly reduce GHG emissions and are a significant part of the ARB's AB 32 emissions reduction measures, represent an already-existing "GHG price signal" that IOU customers see every month in their current electric and gas bills.

Furthermore, for reasons unrelated to GHG emissions, the IOUs must charge high-usage residential electricity customers prices that far exceed the marginal cost of serving those customers. Pursuant to the Public Utilities Code, there essentially is a cap on the annual increase in the first two tier customers' rates.[23] Because of this structure, customers with usage strictly in Tier 1 and Tier 2 likely experience no or an insignificant rate increase as the result of these

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[22] At the Workshop, the ALJs requested data on the extent to which CSI is included in Tier 1 and Tier 2 customer rates. While CSI and other GHG-related programs, (i.e., RPS, DR, CEE, and SGIP), are technically "included" in Tier 1 and Tier 2 rates, these costs are more than offset due to various Public Utilities Code rate restrictions (see Cal. Public Utilities Code §§ 739.1, 739.2 and 739.9), which provide low-usage and low-income customers dramatic rate discounts that effectively shield them from bearing their share of these program costs. In SCE's case, for example, while all residential rate tiers include a 1.98 ¢/kWh charge that covers cost-recovery for GHG-related programs, the Conservation Incentive Adjustment ("CIA"), which establishes the tiered rate structure, has resulted in a corresponding decrease in rates for Tier 1 and Tier 2 of 4.57 cents and 2.15 cents, respectively. Likewise, Tier 3, Tier 4, and Tier 5 rates increase by an additional 6.23 ¢/kWh, 9.73 ¢/kWh, and 13.0 ¢/kWh, respectively, due to CIA. Therefore, while SCE records equal "revenue recovery" of GHG-related programs for all tier levels, the CIA results in lower effective Tier 1 and Tier 2 rates, leading to, in some cases, residential customers' rates 40% below the system average rate.

[23] Cal. Public Utilities Code §§ 739.1, 739.2 and 739.9.

programs. Instead, customers with usage in Tiers 3 and above bear all the costs associated with these programs. This means that high-usage customer rates already far exceed the marginal cost of providing service to those customers and include a significant and similarly excessive GHG-related price signal.

A similar rate impact due to the costs of GHG reduction programs is seen in rates for commercial and industrial customers. Unlike residential customers, these larger commercial and industrial customers' bills do include significant fixed charges, bringing their variable rates closer to their marginal cost of service. However, commercial and industrial customers still see the costs of GHG reduction measures in the variable portion (as opposed to fixed charges) in their bills. Tables 1-3 below shows these variable, GHG-related charges for each commercial and industrial customer class, disaggregated by utility. For example, marginal rates for SCE's commercial and industrial customer classes include, on average, a 1.65 cent/kWh charge associated with the GHG reduction costs, including RPS,[24] energy efficiency, the Self-Generation Incentive Program ("SGIP"), and CSI.

Table 1
SCE GHG-related program costs recovered through variable components of commercial and industrial rates
¢ / kWh

		Variable Bill Component				
		Distribution (1)	Gen (2)	PPPC (3)	CSI (4)	**Total Line Item**
Rate Class	GS-1	0.15	0.95	0.75	0.18	2.03
	GS-2	-	0.94	0.65	0.16	1.75
	TOU-GS-3	-	1.04	0.65	0.12	1.81
	TOU-8-Sec	-	1.02	0.59	0.12	1.73
	TOU-8-Pri	-	0.86	0.53	0.11	1.49
	TOU-8-Sub	-	0.66	0.36	0.07	1.09

24 The RPS costs included in Tables 1-3 below throughout reflect only those costs in excess of business as usual procurement, not the full renewable premium.

Table 2
PG&E GHG-related program costs recovered through variable components of commercial and industrial rates
¢ / kWh

		Variable Bill Component				
		Distribution (5)	Gen (2)	PPPC (3)	CSI (4)	Total Line Item
	Small Commercial	0.04	1.00	0.77	0.16	1.99
	Medium Commercial	0.01	0.88	0.64	0.16	1.68
Rate Class	E-19	-	0.54	0.56	0.14	1.24
	E-20S	-	0.51	0.54	0.14	1.19
	E-20P	-	0.49	0.44	0.12	1.06
	E-20T	-	0.41	0.28	0.09	0.78

Table 3
SDG&E GHG-related program costs recovered through variable components of commercial and industrial rates
¢ / kWh

		Variable Bill Component				
		Distribution (6)	Gen (2,7)	PPPC (3)	CSI (4,8)	Total Line Item
	Small Commercial	0.17	0.4	0.9	0	1.47
	Med & Lg C&I	0.14	0.39	0.7	0	1.23
Rate Class	AD	0.25	0.39	0.7	0	1.34
	AL-TOU	0.16	0.39	0.7	0	1.25
	AY-TOU	0.21	0.39	0.7	0	1.30
	A6-TOU	0.03	0.39	0.7	0	1.12

Notes:
Values for all utilities based on currently effective rates
1. Distribution revenues (SCE) include SGIP and demand response ("DR") programs. Medium and large power (GS-2 and above) DR program costs are recovered through fixed demand charges
2. Generation ("Gen") revenues include the energy-related portion of above-market RPS costs and DR programs; revenue recovered through capacity charges are not included.
3. Public Purpose Program Charge ("PPPC") includes CEE program revenues.
4. CSI includes California Solar Initiative revenues.
5. Distribution revenues (PG&E) include SGIP and DR programs. E-19 & E-20 DR program costs are recovered through demand charges.
6. Distribution revenues (SDG&E) include SGIP and DR programs. For Medium and Large Commercial and Industrial ("Med & Lg C&I"), portions of these program costs are recovered through fixed demand charges
7. These estimates of the RPS are incremental above-market costs. These costs are forecasted to increase significantly.
8. SDG&E has suspended 2012 collection of CSI revenue requirements (to instead be recovered in 2013-2016).

These numbers clearly show that, even without an additional "GHG price signal" created by the withholding of allowance values, commercial and industrial customer variable rates already include a significant GHG-related charge.

c) Any Additional Retail Price Signal Would Not Be Accurate

It is important that any price signal used at the retail level be accurate; however, this is not possible due to the IOUs' current rate structure. As explained above, because of the residential tiered rate structure in California, customers with usage strictly in Tier 1 and Tier 2 will experience no or insignificant rate increases as the result of the cap-and-trade program, while customers with usage in Tiers 3 and above will bear all the costs for their customer class associated with this program, further distorting rates. Although the IOUs are elsewhere advocating for reforming the distortions in residential tiered rates, those tiered rates are likely to be in effect during the initial implementation of AB 32. Likewise, commercial and industrial rates include GHG-related costs, primarily in the marginal component of their rates.

Thus, adding a further "GHG premium" on top of these customers' existing rates would only distort their price signals further. In fact, a fixed rebate method of distributing allowance revenues, which some argue creates or preserves a price signal, might actually send a negative price signal. For example, residential customers with usage in lower tiers will see an overall bill *decrease* due to the cap-and-trade program and so may have an incentive to *increase* energy consumption. Arguments for the use of a fixed rebate over a cost-based return of allowance revenues on grounds that a fixed rebate would avoid suppressing or dampening the price signal should not be made in the abstract, but should take into account the context of California's existing rate structures.

d) Any Additional Retail Price Signal Would Not Be Cost-effective

The use of such an additional GHG price signal is not a cost-effective method of reducing emissions relative to other emissions reductions options. This is because the price elasticity of demand for electricity is extremely low, meaning that it would take an extremely large increase

in the electricity rates to get customers to reduce their usage, and thus emissions, by any tangible amount.[25] In fact, given the price elasticity of demand for electricity, actually reducing GHG emissions to AB 32 prescribed levels through a retail-level price signal alone would cost between $375 to $3,000 per metric ton (in contrast to the projected $20 per metric ton allowance price that reflects the market cost of alternative emissions reductions options under the cap-and-trade regime).[26] Therefore, while a price signal extreme enough to achieve tangible emissions reductions is neither practical nor desirable, the price signal currently being proposed will have very little conservation effect.

Because customers do not adequately respond to increases in electricity prices due to the extremely low price elasticity of demand, the ARB and IOUs have relied instead on energy-efficiency incentive programs to achieve the desired cost-effective emissions reductions. This has been evidenced by significant IOU spending on energy efficiency and the ARB's reliance on energy efficiency as a complementary policy to the cap-and-trade program. These programs operate by providing rebates and subsidies for various energy efficiency technologies, which reduce the cost of the energy efficient actions relative to the price of electricity. This past reliance on programs such as energy efficiency to achieve conservation is due to a general recognition that a GHG price signal is not a cost-effective way to reduce electricity consumption.

Moreover, one of the reasons the cap-and-trade program was selected instead of other regulatory options was because it allowed flexibility for market participants to choose the most cost-effective approach to achieve collectively the cap among a range of options. Because total GHG emission levels are capped under the cap-and-trade structure, the levels of emissions reductions to be achieved under the program are already set. Therefore, if emissions reductions are made by way of rate increases that cause customers to use less electricity, there will be fewer emissions reductions made through other, more cost-effective measures, such as switching to

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25 For an overview of price elasticity of demand, see Appendix A.

26 For an illustration of the significant and sizable disparity between actual price elasticity and the elasticity that would be necessary to achieve cost-effective emissions reductions through conservation, see Appendix B.

more efficient and clean generation. For all of these reasons, reliance on an additional retail-level price signal should be avoided.

7. Not Necessary: Distribute revenues equitably recognizing the "public asset" nature of the atmospheric carbon sink

The Joint IOUs have a "customer-centric" rather than "public asset" view as to what it means to distribute revenues equitably. This is because, from a practical standpoint, the principle underlying this objective – that everyone owns an equal share of the atmosphere and is therefore entitled to an equal share of the total "rent" that is the allowance revenues – is impossible to advance equitably under electricity ratemaking principles. For example, using a *per household* rebate to achieve this objective (i.e., as a proxy for a *per capita* return) would result in renters served through master meters not necessarily receiving their fair portion of allowance revenues, while owners of multifamily residences would receive multiple allowance revenue allocations. Because the Joint IOUs have, through the introduction of an additional policy objective, more appropriately defined equity in the context of the current electricity rate structure in California, the Joint IOUs rank this policy objective as "Not Necessary."

8. Not Necessary: Correct for market failures that lead to ongoing underinvestment in GHG mitigation activities and technologies

As stated above, a cap-and-trade program achieves emissions reductions through creating a wholesale market price signal that encourages investment in GHG mitigation activities and technologies. Providing direct incentives to certain technologies duplicates the effects of the cap-and-trade program itself. Accordingly, this is not an appropriate policy for the use of allowance revenues, as it will be sufficiently achieved as soon as the cap goes into effect.

IV.

JOINT IOU PROPOSAL FOR USE OF ALLOWANCE REVENEUES

A. Explanation of Proposal

1. Return of Allowance Revenues to Customers Through ERRA

In this Joint IOU Proposal, the IOUs recommend allocating 100 percent of AB 32 allowance revenues in each IOU's Energy Resource Recovery Account ("ERRA") forecast proceeding. This allocated revenue to customer classes will be used to reduce a delivery rate component (e.g., distribution) that all customers, including DA and CCA customers, pay.[27] The AB 32 allowance revenues will be allocated to rate groups based on Commission-approved generation cost allocators and returned to customers in proportion to the AB 32 costs included in their generation rates. Both costs and revenues will be included in rates based on an ERRA forecast approved by the Commission, which will be adjusted based on the actual amount of costs incurred and allowance revenues returned, through the use of balancing accounts. Using this methodology, customers receive the benefit of the allocated allowance revenues in proportion to and at the same time as they incur AB 32 costs, beginning January 1, 2013.[28]

2. Allowance Revenue Return Used to Cover All AB 32 Costs

The Joint IOUs propose returning allowance revenues to customers to mitigate not only direct cap-and-trade compliance costs but all costs associated with AB 32 emissions reduction measures. It was the clear intent of the ARB in allocating free allowances to the IOUs to compensate customers for actions taken to reduce GHG emissions prior to the cap-and-trade

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27 *See* Joint Exhibit of Pacific Gas and Electric Company, Southern California Edison Company, and San Diego Gas & Electric Company Pursuant to June 2, 2011 Administrative Law Judge's Ruling.

28 In PG&E's case, this includes equitable allocation of allowance revenues to the Bay Area Rapid Transit ("BART") district based on distribution services provided to it by PG&E, even though BART procures its electricity commodity from alternative sources.

program becoming effective as well as for GHG-emissions reducing initiatives in addition to cap-and-trade, such as the RPS. Because these measures impose costs on electricity customers that are substantially in excess of the value of allowances to be allocated to the IOUs under the cap-and-trade program, the Joint IOUs propose allocating 100% of the allowance revenues directly to customers.

a) ARB Intended that Allocated Allowances be Used to Cover AB 32 Costs

The ARB never intended to limit the use of allowance revenues exclusively for the mitigation of the direct costs of the cap-and-trade program. In fact, the ARB explicitly allocated allowances to electric utilities to reward their customers for efforts taken to reduce GHG emissions *before* the onset of the cap-and-trade program. These efforts are referred to by the ARB as "early action" measures.[29] Likewise, the ARB expressly provided that allowance revenues should be used "to support policies and programs that are reducing GHG emissions from the electricity sector,"[30] without limiting this support to exclusively cap-and-trade. As explained in the ARB's Final Statement of Reason ("FSOR"):

> [t]wo important and related principles for the allocation to the electric sector were recognizing early actions made by individual utilities to reduce GHG emissions and the expectation that all electric distribution utilities would continue to aggressively reduce their emissions intensity in accordance with California's 33 percent RPS goals.[31]

The FSOR further explained that this allocation was to cover the cost burden associated with AB 32 Scoping Plan measures beyond the cap-and-trade program, stating that the "electric utilities are allocated allowances to cover part of the total cost burden that AB 32 Scoping Plan measures

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29 *See* Appendix 1: Staff Proposal for 15-day Changes to Address Electricity Sector Allowance Allocation at 2, (dated December 16, 2010) available at: http://www.arb.ca.gov/regact/2010/capandtrade10/res1042app1.pdf (providing that one policy objective for allowance allocation is recognizing "early action by incorporating the use of State-defined eligible renewable energy from 2007 to 2011.").

30 *Id.*

31 FSOR at 1435.

add to the costs ultimately born by ratepayers. These costs include the relatively high costs of the 33 percent renewable portfolio standard…"[32] Accordingly, limiting the return of allowances to cover only cap-and-trade costs (rather than all AB 32 costs) contradicts the clear intent and purpose of the ARB allowance allocation. Accordingly, the Joint IOUs propose to use allowance revenues to compensate customers for all of their AB 32 costs, rather than cap-and-trade program costs alone.

b) Because AB 32 Costs will Inevitably Exceed the Value of Allowances, 100% of the Allowance Revenues Should Be Allocated to Customers

The IOUs acknowledge that the value of allowances at times may exceed the direct costs that customers, in aggregate, may bear for the cap-and-trade program, such as early in the cap and trade program. However, as already explained, the purpose of the allowance allocation was to cover costs associated with all AB 32 emissions-reductions measures in addition to cap-and-trade, such as the RPS, CSI, CEE and CHP.

It is also clear, however, that all these AB 32 costs borne by customers will far exceed the value of the IOUs' allowances. The ARB recognized this fact, stating that "electricity utilities are allocated allowances to cover *part of* the total cost burden that AB 32 Scoping Plan measures add to the costs ultimately born by ratepayers."[33]

In fact, a conservative estimate of the costs of just a few of these additional emissions reduction measures approved by the ARB as part of AB 32 – i.e., RPS and CSI – in addition to direct cap-and-trade costs, far exceed the projected revenues derived from the IOUs' allocation of allowances. According to E3's Evaluation Metrics Calculator[34] prepared for the Commission for the 2010 LTPP, the costs of these combined programs will be at least $32.2 billion from 2013

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32 FSOR at 1570.

33 *Id.* (emphasis added).

34 Submitted in LTPP on July 1, 2010. Available at: http://www3.sce.com/law/cpucproceedings.nsf/vwMainPage?Openview&RestrictToCategory=Track%20I%202010%20LTPP&Start=1&Count=25 ("LTPP_EMC_2011-07-01.xlsm"). See Appendix C for more details.

through 2020. Comparatively, the projection is that the total value of the allowances allocated for IOU customers will be around $12.3 billion. In other words, the cost of just these two AB 32 programs is projected to be around $19.9 billion more than the total value of allocated allowances. (See Appendix C for more details).

3. Customer Education and Outreach

The Joint IOUs are committed to communicating and informing their customers on environmental policy and electricity rates and believe that a well-defined and targeted customer education and outreach plan on AB 32 is an essential element of an allowance revenue return proposal. To this end, the Joint IOUs recommend that the Commission and all stakeholders in this proceeding collaborate on development of an AB 32 customer outreach and education plan in preparation for the beginning of compliance with the GHG cap-and-trade program at the start of 2013. The Joint IOUs recognize that the exact form of any outreach and education plan will be largely contingent on the Commission's final ruling on the matter of allowance revenue return, and recommend that this eventual decision include development of such an outreach plan. In order to begin an active dialogue with all stakeholders, however, the Joint IOUs suggest that initial discussion on the development of possible customer education and outreach plans, along with options for funding the plan, begin starting at the January 11, 2012 workshop in this proceeding.

A comprehensive customer outreach and education plan can accomplish several of the key goals of this proceeding, consistent with the mutual goals of the Joint Utilities and other parties on rate design issues. First, through education and outreach, customers can be provided coordinated, comprehensive information about the AB 32 GHG reduction goals and the benefits of California's role as a leader in addressing climate change in a reasonable, effective way through the AB 32 cap and trade program and other GHG-reducing policies and initiatives, such as energy efficiency programs, the RPS, and the CSI. Second, education and outreach could provide customers with the information and tools to cost-effectively manage the longer-term

impact of AB 32 programs (including cap and trade) on electricity costs without creating an undue burden in the short term. Part of this message would be to reinforce conservation and energy efficiency programs and emphasize the steps they can take to reduce their own GHG emissions. In short, a well-planned education and outreach effort, supported by the IOUs, the Commission, and key stakeholders and policymakers, can effectively communicate to customers the costs the IOUs are incurring to reduce the electricity and natural gas GHG emissions on their behalf. Further, it can reiterate the benefits of promoting energy efficiency and conservation in achieving GHG reductions. Such an approach would encourage customers to take actions to reduce GHG emissions while at the same time mitigating the inequities and backlash to the AB 32 cap and trade program that could result from passing along distorted and ineffective price signals to customers.

The Joint IOUs have identified the following issues that stakeholders should address in designing a potential education and outreach program:

1. Development of a simple, understandable message will be critical in light of the complex relationship of AB 32 with California's already complicated system of tiered and non-tiered electricity rates. As has been learned with the roll-out of Advanced Metering Infrastructure in California, information provided to customers must be conveyed very carefully and clearly in order to avoid confusion and backlash against AB 32 and its goals.
2. California has a diverse mix of residential and business customers that varies by IOU territory. Therefore, the IOUs expect that there will not be an effective one-size-fits-all approach to customer outreach. Each IOU's service territory will likely require development of education and outreach programs targeted to the specific characteristics of the customers in its service area. Particular attention could be given to low-income customers, customers in communities that may experience adverse impacts, and small businesses, i.e., customer groups identified in AB 32 for special attention.

3. Coordination with other proceedings and other agencies is needed to develop a customer outreach and education plan that provides consistent messages. For example, a CPUC-approved outreach plan will need to be coordinated with other newly contemplated outreach efforts, such as by the ARB or local air districts, as well as with IOU-specific efforts currently underway, such as outreach on energy efficiency, conservation and rate changes resulting from each IOU's general rate case ("GRC"), other major rate cases, and rate changes related to implementation of time-of-use pricing. IOUs already anticipate the need to carefully coordinate customer outreach on several significant rate changes and initiatives over the next several years due to AB 32 and other energy and environmental policy initiatives.
4. Any education and outreach program needs to be implemented in a way that imposes as little incremental pressure on customer rates as possible. The Joint IOUs already have significant experience implementing Demand Side Management ("DSM") education and outreach campaigns. Accordingly, the Joint IOUs anticipate that the most cost-effective way to implement an AB 32 education and outreach program will be to coordinate that program with the extensive DSM education programs already in place in each IOU's service area. The scope of the potential AB 32 outreach program will also depend on the allowance revenue return methodology that the Commission chooses, but the Joint IOUs believe an effective outreach plan can be implemented at reasonable cost if their proposal for proportional return of the revenues is adopted. Specific costs and cost recovery proposals for the customer outreach plan must be part of the final plan, including consideration of funding sources, such as use of a portion of the allowance revenues.
5. The customer education and outreach program requires significant lead time to develop and plan, including approval by the Commission of plans for recovery of the reasonable costs of the program in IOU rates

The Joint IOUs look forward to receiving feedback and suggestions from the Commission and other stakeholders in comments on this proposal and welcome further discussion beginning at the January 11 workshop.

B. Anticipated Rate Impacts of Joint IOU Proposal

One of the main advantages of a volumetric return of allowance revenues to customers is that it prevents any customer from seeing sudden or significant rate increase from the implementation of the cap-and-trade program. Through this approach, AB 32 allowance revenues would be used to mitigate a portion of the AB 32 costs, covering a portion of the costs of existing AB 32 programs and measures to promote the goals of AB 32 (that is, CEE, RPS, CSI and CHP, among others). Because each customer will receive allowance revenues in proportion to the costs that customer incurs, this method minimizes rate increases for all customers more than any other allocation. While this approach will not mitigate the substantial differentials in rates imposed on residential customers by California's steeply tiered rate structure, it is the best way to avoid further exacerbating these differentials. This proposal will not impact the electricity price signals sent to the utilities and other participants by the wholesale power markets, which will fully include the "price" of GHG in electricity costs.

C. Coordination Across Other Proceedings

Because the Joint IOU Proposal advocates for directly returning 100 percent of the allocated revenues to customers through rates, there is little coordination with other proceedings required. As stated, the AB 32 allowance revenues forecast will be incorporated into each utility's ERRA proceeding for 2013 and beyond. The only coordination required by the Joint IOU Proposal will be coordination of any customer education and outreach program. It should be noted that the lack of need for regulatory coordination as well as the simple calculations necessary to implement the Joint IOU Proposal will greatly assist in fulfilling the administrative-ease policy objective.

Rate design issues such as equity among customer classes are debated in the Phase 2 of each IOU's GRC where the Commission makes its determination on how rates should be set across all customer classes. This proceeding should not be used to change these Commission determinations. By returning the allowance revenue to customers in proportion to GHG costs incurred, the rate design developed in the GRC will be maintained.

Furthermore, the levels of funding of each of the AB 32 programs, e.g., CEE, RPS, CSI and CHP, should be determined in proceedings where spending proposals are judged on their merits, independent of the amount of incremental funding available from allowance revenues. Funding for these programs should be determined in their respective proceedings to ensure the cost effectiveness of those programs and that the appropriate stakeholders are involved in the decision-making process.

There is also a benefit of simplicity to avoiding multiple CPUC proceedings with the same objective and potentially overlapping programs for both the Commission and stakeholders. Using this proceeding to develop energy efficiency, RPS, and/or solar programs is an inefficient use of parties' resources and could lead to a duplicative and wasteful use of revenues. As SDG&E found with demand response programs, independent efforts aimed at the same customer base simply led to the cannibalization of some efforts by other efforts.[35] Simplicity would argue for keeping AB 32-related programs in already existing proceedings on RPS, CEE, CSI, and CHP.

D. The Need for Commission-Approved Accounts to Facilitate the Accrual of Revenues, if Necessary

Except for costs to implement the customer education and outreach program, the Joint IOU Proposal does not require the creation of any new Commission-approved accounts or rate

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[35] A.11-03-002, Testimony of Mark Gaines at MFG-9 and MFG-10 (explaining that because 63% of customers on the DR aggregators' program were on another SDG&E DR program, the Capacity Bidding Tariffs, prior to the DR aggregators' program, the new program did not result in significant incremental peak reductions).

mechanisms to facilitate the allocation of revenues or recovery of costs. This approach is administratively simple for the IOUs to implement.

E. Existing Statutory or Commission Mandates That May Affect or Limit the Implementation of the Joint IOU Proposal

No existing statutory or Commission mandates restrict the implementation of the Joint IOU Proposal if approved by the Commission.

V.

DISCUSSION OF HOW THE JOINT IOU PROPOSAL DOES OR DOES NOT ADVANCE THE POLICY OBJECTIVES

The Joint IOU Proposal will achieve critical policy objectives by containing customer costs and allowing members of the electricity sector to select GHG reduction measures that are the most cost-effective. The proposal ensures the most equitable allocation, in that it does not further unmoor the cost of service from each customer's responsibility for that cost by creating additional cross subsidies. Furthermore, the proposal does more than any other proposal to ensure that no customer will experience sudden rate increases. It also provides a level playing field for all LSEs, maximizes administrative ease and mitigates leakage. The Joint IOUs have presented the main arguments behind the relative importance of each of these policy objectives above, and briefly summarize how each policy objective is advanced by the Joint IOU Proposal below.

A. The Joint IOU Proposal Mitigates Costs for All Customers and Ensures Cost-effectiveness of Emissions Reductions Measures

One of the main advantages of a return of allowance revenues in proportion to customer AB 32 costs through rates is that it prevents any electricity user from seeing sudden or significant rate increases. Through this approach, AB 32 allowance revenues would be used to compensate those electricity users, who are paying the AB 32 costs. Because each customer will receive

allowances on the same basis as costs incurred, this program protects all customers against significant rate increases more than any other method. In contrast, and as detailed above, other proposals could result in significant customer rate increases for at least some customers, and may potentially allow some other customers to inequitably experience rate decreases.

B. The Joint IOU Proposal Ensures an Equitable Return of Allowance Values to All Customers

Another significant advantage of the Joint IOU Proposal is that it adheres to equity principles articulated by the Commission, namely cost causation, avoidance of cross-subsidization. As explained above, California's rate structure imposes AB 32 costs on upper tier residential customers in excess of the AB 32 related responsibility attributable to these customers. These customers will subsidize the costs of AB 32 (among other costs) caused but not incurred in rates by lower-tier and CARE customers. Returning allowance revenues through a fixed rebate or through a per kilowatt hour credit to usage in all tiers will further exacerbate this cross-subsidy. Additionally, the use of revenues to fund other programs will impose a greater cost on upper tier customers, since the costs imposed on lower tier and CARE customers are essentially capped. Only by returning the allowance revenues to customers in proportion to the AB 32 costs they incur, can the Commission avoid further eroding the equitable cost-causation principles on which California's rate structure is based.

C. The Joint IOU Proposal Maintains Competitive Neutrality Across Load-Serving Entities

The Joint IOU Proposal would put the IOUs on par with other LSEs with respect to the use of allowance revenues. Revenues would be returned to DA and CCA customers on the same basis as IOU bundled service customers through distribution rates.

The Joint IOU proposal also maintains neutrality between IOUs and publicly-owned utilities ("POUs"). POUs will also receive an allocation of allowances from the ARB but, unlike the IOUs, the POUs are not required to consign these allowances to auction; the POU allowances

can be used for direct compliance or to offset AB 32 costs to their customers. Without the ability to use these allowances in the same manner as the POUs, IOU customers will be at a disadvantage in that they could experience rate increases as a result of cap-and-trade, whereas POU customers will not.

Furthermore, requiring IOUs to use the allowance revenues to fund additional energy efficiency or renewable generation programs, rather than provide direct bill relief to their customers, will have the effect of placing a disproportionate share of the costs of GHG compliance on DA, bundled service and CCA customers. POU ratepayers will be able to avoid contributing allowance revenues to these programs while still reaping the benefits of them. All California electricity customers should bear the cost burden associated with these programs. Accordingly, allowing the IOUs to pass the allowance revenues along to their customers is the only approach that ensures equal treatment among the various LSEs.

D. The Joint IOU Proposal Provides the Most Administratively Simple and Understandable Approach

The proportionate approach has the added benefit of administrative ease. Each IOU will be able to allocate the allowance revenues in proportion to costs seamlessly by reducing the delivery rate component of each customer's energy bill. The administration of a fixed rebate would require costly adjustments to the Joint IOUs' current billing systems.[36] Furthermore, the complicated nature of a fixed rebate would require much more extensive and costly customer explanation, outreach and communications than the Joint IOU Proposal. Additionally, fixed rebates lead to complicated temporal issues, because they usually occur as a one-time lump-sum payment. For example, if a residential customer incurs monthly costs associated with GHG

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36 *See, e.g.,* PG&E's Response to DRA Data Request (estimating that PG&E's costs of implementing an annual or semi-annual rebate check would range from approximately $3 million to $6 million annually), SCE's Response to DRA Data Request (estimating that SCE's costs of implementing an annual or semi-annual rebate check would range from approximately $5.5 million to $8.5 million annually); SDG&E's Response to DRA Data Request (estimating that SDG&E's costs of implementing an annual or semi-annual rebate check would include an initial $85,000 to establish and $225,000 of on-going incremental costs per occurrence).

compliance and then moves before receiving the associated rebate, the IOUs must take measures to find this customer at his or her new residence in order to ensure that the fixed rebate is properly paid. This process is neither efficient nor inexpensive.[37] Accordingly, the proportionate approach is the preferred approach from an administrative standpoint.

E. The Joint IOU Proposal Protects All Customers Including Low-Income Customers Against Rate Increases

The Joint IOU Proposal advances the objective of reducing adverse effects on low-income households by ensuring that no customer experiences sudden or significant rate increases as a result of the cap-and-trade program. While the Joint IOU Proposal does not provide funds for low-income customers in excess of their costs, this is because there are already programs in place to ensure that these customers are fully protected such as California Alternate Rates for Energy ("CARE") program.[38]

While some parties have advocated for a fixed rebate approach on grounds that this approach provides additional benefits to low-income customers, a fixed rebate is neither an accurate nor an effective means of wealth redistribution. This is because, for non-CARE customers, there is not an exact correlation between energy usage and income.[39] For example, a low-income customer living in a desert area may be paying Tier 4 rates, whereas a wealthy resident living on the coast could be paying Tier 1 or 2 rates only. Under a fixed rebate approach, some low-income non-CARE customers who use high volumes of energy could be subject to a disproportionately high electricity rate increase, while other high-income, low-usage customers could receive a bill reduction. Because the tiered rate structure is based on energy usage rather than customer ability to pay, and given that low-income customers are already

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37 *Id.*

38 The CARE program is set forth in California Public Utilities Code § 739.1.

39 *See* Borenstein, Severin, Presentation Slides from 2008 POWER conference, "How Much Does Increasing-Block Electricity Help Low-Income Customers?" a*vailable at* http://www.ucei.berkeley.edu/POWER-08/Files/02borensteinslides.pdf.

protected by statute and Commission regulations, there is not a strong equity argument for returning the allowance revenue through a fixed rebate.

The Joint IOUs recognize that low-income customers may also be impacted by the indirect costs of cap-and-trade, namely, an increase in the price of all goods and services. However, the return of allowance revenues in the manner proposed by the IOUs would lower the costs borne by commercial and industrial customers, thereby mitigating this result. To the extent that the legislature determines that low-income customers require additional assistance as a result of economic pressures resulting from the cap-and-trade program or from climate change, generally, such assistance is more effectively administered directly under the programs for low-income customers already in place.

In addition, AB 32 impacts on low-income households and other families may be addressed by the Legislature through the pre-existing and separate allocation of a significant portion of the AB 32 allowance revenues to the Air Pollution Control Fund for programs to assist, *inter alia,* low income and other impacted consumers and communities. This separate allocation already has been adopted in the AB 32 rulemaking and is separate from the allocation of remaining AB 32 allowance revenues pending in the CPUC proceeding. The Governor's 2012-2013 California budget proposal assumes that $1 billion in these already-allocated allowance revenues will be available in the Air Pollution Control Fund for purposes such as "investing in local communities already affected by air pollution and communities disproportionately vulnerable to the effects of GHG emissions."[40]

F. The Joint IOU Proposal Mitigates Economic Leakage

The Joint IOU Proposal will mitigate the costs borne by EITE customers, thereby avoiding economic leakage. As the California Large Energy Consumers Association ("CLECA") stated in its prehearing conference statement, "[i]f the Commission were to direct

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[40] Governor's 2012- 2013 Budget Summary, p. 98..; AB 32 Final Rule, FSOR, p. 1124; see also ARB Board Resolution 10-42, December, 2010, p. 12 .

that 100 percent of the allowance auction revenues should be returned to ratepayers in general proportion to their usage of electricity, it would go a very long way to solving the question of 'leakage' with respect to the cost of indirect emission costs for these firms."[41] It is the Joint IOUs' position that a 100 percent return of allowance revenues to customers (including DA and CCA customers) based on their AB 32-associated costs would sufficiently mitigate economic leakage.

G. The Joint IOU Proposal Preserves Carbon Price Signals at the Wholesale and Retail Levels

As already explained, the Joint IOU Proposal preserves the GHG price signal at the wholesale level, which is the point of regulation in any cap-and-trade program and the level where the most effective price signal in the cap-and trade market will be generated. The current residential tiered rate structure in California and existence of AB 32 programs that are lowering emissions in California, have already established a more than sufficient retail-level price signal. The Joint IOU Proposal does not attempt to change the already existing price signals at the retail level. Any approach used to achieve an additional retail-level price signal would send a duplicative, inequitable and less accurate price signal at best.

H. No Proposal Could Distribute Revenues In a Manner that Equitably Recognizes the "Public Asset" Nature of the Atmospheric Carbon Sink

Given the practical limitations on achieving this objective, no proposal should attempt to distribute revenues in a way that achieves this policy objective.

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41 *See* Pre-hearing Conference Statement of the California Large Energy Consumers Association at 9 (filed April 21, 2011).

I. No Additional Funds are Needed to Account for Market Failures that Lead to Ongoing Underinvestment in Carbon Mitigation Activities and Technologies

The cap-and-trade program is structured in order to promote investment in the most cost-effective and successful GHG mitigation activities and technologies. The use of allowance revenues to fund additional investment in such programs would have a distortionary effect and should therefore be avoided.

VI.

DISCUSSION OF HOW THE JOINT IOU PROPOSAL INCORPORATES PREVIOUS ARB AND COMMISSION GUIDANCE AND THE JURISDICITIONAL LIMITATIONS OF EITHER AGENCY THAT MAY AFFECT IMPLEMENTATION OF THE PROPOSAL

At the time the Ruling was issued, the ARB draft regulations included language directing the utilities to use a fixed rebate or bill credit to return the allowance revenues to customers. The Joint IOUs challenged this language in the ARB draft regulation on the grounds that such a determination – which involves issues of ratesetting and rate design – falls squarely within the plenary jurisdiction of the Commission.[42] The IOUs also made the point at the ARB, on the same policy grounds asserted in this Joint IOU Proposal, that an approach of returning the allowance revenues in proportion to cap-and-trade program costs would lead to a more cost-effective, equitable and administratively efficient outcome than a fixed rebate. In its final cap-and-trade regulation, the ARB removed the fixed rebate language.[43] Accordingly, the

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42 *See* Comments of Southern California Edison Company to the California Air Resources Board on its Proposed 15-Day Modifications to the Cap-and-Trade Regulation, Released July 25, 2011 at 8-9 (filed August 11, 2011); SDG&E's Draft Final Comments on ARB's Proposed 15-Day Modifications to the Cap-and-Trade Regulation at 16 (filed August 11, 2011); PG&E's Comments on the Air Resources Board's July 25, 2011 Proposed Modifications to the AB 32 Cap-And-Trade Regulation at 17 (filed August 11, 2011).

43 Cap and Trade Final Regulation Order (filed December 22, 2011). Available at: http://www.arb.ca.gov/regact/2010/capandtrade10/finalrevfro.pdf.

jurisdictional issue related to the fixed rebate language has been resolved. There are no jurisdictional issues that would affect the implementation of the Joint IOU Proposal.

In 2008, the Commission provided recommendations in Ordering Paragraph 15 and 16 of D.08-10-037:

> 15. We recommend that ARB require that all allowance auction revenues be used for purposes related to Assembly Bill (AB) 32, and that ARB require all auction revenues from allowances allocated to the electricity sector be used to finance investments in energy efficiency and renewable energy or for bill relief, especially for low income customers.
>
> 16. We recommend that ARB allow the Public Utilities Commission for load serving entities and the governing boards for publicly-owned utilities to determine the appropriate use of retail providers' auction revenues consistent with the purposes of AB 32 and the restrictions recommended in Ordering Paragraph 15.[44]

The Joint IOU Proposal is entirely consistent with the Commission guidance in that it provides bill relief to all affected customers to mitigate the costs of the cap-and-trade program as well as the costs of other AB 32-related programs, such as energy efficiency and renewable energy.

In the same Decision, the Commission also stated that "any mechanism implemented to provide bill relief be designed so as not to dampen the price signal resulting from the cap-and-trade program."[45] In this Joint IOU Proposal, the IOUs have repeatedly argued that the Joint IOU Proposal would not affect the wholesale price signal. Additionally, the costs for AB 32 programs embedded in rates and the current rate structures already provide a sufficient retail-level price signal. Indeed, in the case of the tiered residential rate structure, a much stronger price signal exists than that which would result from the cap-and-trade program. Moreover, prior Commission and ARB guidance has called for programs that limit rate increases to customers, a goal that is consistent with the Joint IOU Proposal. Accordingly, the Joint IOU Proposal is

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[44] It should be noted that this Decision was issued before the State adopted the 33 percent RPS and SB 695 protections for low-income and low usage customers.

[45] D.08-10-037 at 225.

consistent with previous guidance provided by the Commission and ARB with respect to this issue.

VII.

CONCLUSION

For all of the reasons discussed herein, the Commission should adopt the Joint IOU Proposal.

Respectfully submitted on behalf of the Joint IOUs,

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Appendix A

Price Elasticity of Demand: The Basics

Price Elasticity of Demand: The Basics

Definition

Price elasticity of demand is a metric by which you can measure a consumer's responsiveness to changes in product price

Calculation

Price elasticity of demand is simply calculated by computing the ratio of an increase in price of a product compared to the resulting decrease in demand for that product:

$$E = \frac{\text{\% change in product demand}}{\text{\% change in product price}}$$

High vs. Low Elasticity

- High elasticity of demand is observed when a small increase in a product's price spurs a very large decrease in demand for that product
- Low elasticity of demand is just the opposite, when even a large increase in the price of a product does very little to change demand
- Luxury goods tend to have higher price elasticities of demand ($E > 1$), while necessities have much lower elasticities ($E < 1$)

Examples*

Low Elasticity	
Salt	0.1
Electricity**	0.1
Gasoline	0.2
Physician services	0.6

High Elasticity	
Restaurant meals	2.3
Airline travel	2.4

*Source: *Economics: Private and Public Choice*, James D. Gwartney and Richard L. Stroup, either edition 1997. Site: http://www.mackinac.org/article.aspx?ID=1247, accessed September, 2011.

** Source: See above in this filing, page 17

Appendix B

GHG Reduction Costs of a Retail Price Signal

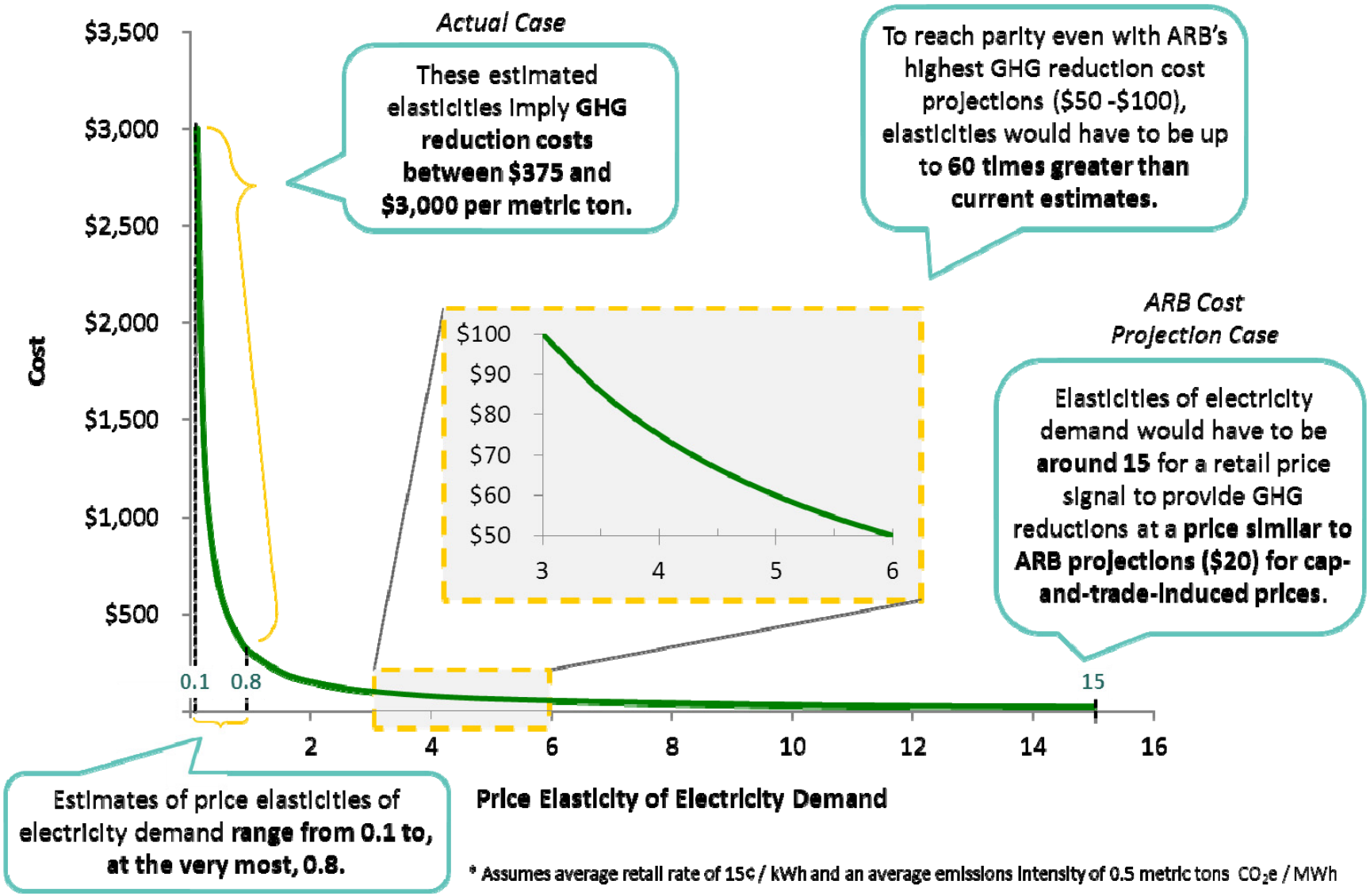
GHG Reduction Costs of a Retail Price Signal

Under the cap-and-trade program, the marginal cost of emissions reduction will be established by the market-clearing price of allowances, and is expected by ARB to be between $15 and $30 per ton. Using $20 as a representative value, reducing each additional ton of emissions will cost around $20 per metric ton. Assuming electricity rates of 15 cents per kWh and marginal emissions rates of 0.5 metric tons carbon dioxide equivalent per MWh, then the price elasticity of demand – the percentage change in energy consumption caused by a percentage increase in price – would have to be -15 in order for a retail price signal approach to be cost-competitive with other emissions reduction options. In reality, price elasticity of demand runs from -0.1 to -0.8, meaning that retail consumers are much less responsive to marginal price increases than they would need to be for retail price increases to be a cost-effective means of reducing GHG emissions.

The analysis below illustrates the significant and sizable disparity between actual price elasticities and those that would be necessary to achieve cost-effective emissions reductions based on ARB expected prices. Assuming an elasticity of -0.8, the cost of reducing GHG emissions levels would be $375 per metric ton compared to the expected market price of $15-$30 per metric ton. At a short-run elasticity of -0.1, the cost of reductions is an order of magnitude higher at $3,000 per metric ton. Therefore, raising retail electricity prices is less cost-effective than potential measures other participants in the cap-and-trade program may undertake to reach the emissions cap. One of the reasons the cap-and-trade program was selected instead of other regulatory options was because it allows flexibility for market participants to choose the most cost-effective approach to collectively achieve the cap among a range of options, thus spurring investment in these approaches. Accordingly, emphasis on raising retail-level rates is not necessary, since expected reductions likely will be achieved at far less cost elsewhere in the California economy.

GHG Reduction Costs of a Retail Price Signal*

$ / metric ton



* Assumes average retail rate of 15¢ / kWh and an average emissions intensity of 0.5 metric tons CO_2e / MWh

Appendix C

Cost of Selected AB 32 Program Costs as Compared to Allocated Allowance Revenue

Cost of Selected AB 32 Program Costs as Compared to Allocated Allowance Value

All costs in nominal dollars

	2013	2014	2015	2016	2017	2018	2019	2020
Direct Net Cap-and-Trade Compliance Costs ($MM)[46]								
Gross Utility Allowance Cost	$366	$435	$482	$553	$625	$703	$782	$867
GHG Cost Embedded in Market Purchases	$584	$651	$612	$647	$671	$735	$745	$818
GHG Savings Due to RPS Resources	($20)	($26)	($55)	($63)	($72)	($82)	($93)	($104)
Total IOU cost	$931	$1,060	$1,040	$1,137	$1,224	$1,356	$1,434	$1,581
Selected Program Costs ($MM)[47]								
California Solar Initiative	$177	$177	$174	$49	$0	$0	$0	$0
Renewable Portfolio Standard[48]	$1,459	$1,756	$2,597	$2,903	$3,202	$3,159	$3,514	$3,276
Selected Program Total Cost	$1,636	$1,933	$2,771	$2,952	$3,202	$3,159	$3,514	$3,276
Revenue from Allowance Sales								
Allocated GHG Permits (millions)[49]	50.43	49.50	48.53	47.55	46.62	45.65	44.67	43.75
Allowance Price ($ per metric ton)[50]	$19.66	$23.24	$26.85	$30.77	$34.72	$39.00	$43.31	$47.98
Net Revenue ($MM)	($991)	($1,150)	($1,303)	($1,463)	($1,619)	($1,780)	($1,935)	($2,099)
Selected AB 32 Program Compliance Cost	$2,567	$2,994	$3,811	$4,089	$4,426	$4,515	$4,947	$4,856
Allowance Revenue	($991)	($1,150)	($1,303)	($1,463)	($1,619)	($1,780)	($1,935)	($2,099)
Net IOU GHG-Related Cost	**$1,576**	**$1,843**	**$2,508**	**$2,626**	**$2,808**	**$2,734**	**$3,013**	**$2,757**

Source: LTPP Evaluation Metrics Calculator, prepared by E3. Submitted for LTPP on July 1, 2010. Can be found in the E3 Workpapers folder at http://www3.sce.com/law/cpucproceedings.nsf/vwMainPage?Openview&RestrictToCategory=Track%20I%202010%20LTPP&Start=1&Count=25 ("LTPP_EMC_2011-07-01.xlsm")

All numbers drawn from Trajectory Case[51] unless otherwise noted

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[46] Costs include cap and trade compliance needs net the emissions reductions benefit from increasing RPS resources.

[47] Compliance costs for other AB 32 emissions reduction measures, such as Energy Efficiency and Combined Heat and Power, are not included, and thus AB 32 costs are understated. In addition, costs of energy efficiency and low income assistance programs funded by allowance revenues allocated directly to ARB Air Pollution Control Fund are not included

[48] Calculated by comparing Revenue Requirement Buildup under Trajectory Case (see note below) against the All Gas Case (which assumes current California renewable penetration levels of approximately 12.5%). This stream thus incorporates increases in procurement costs due to renewables as well as increased need for new transmission, distribution upgrades, and additional flexible resources.

[49] Represents combined IOU allocation net allowances to be used directly for Community Choice Aggregator and Direct Access customers.

[50] The Evaluation Metrics Calculator uses an GHG price forecast based on MPR forecasts, adjusted for metric tons (*see* 'PriceForecasts' sheet)

[51] Trajectory Case assumes that "the state achieves 33% RPS based heavily on contracts signed by California utilities through 2010". *See* Joint IOU / E3 Preliminary Results Presentation filed May 10, (http://www.cpuc.ca.gov/PUC/energy/Procurement/LTPP/LTPP2010/LTPP_System_Plans.htm).

Appendix D

Summary of Changes to October 5 Draft of Joint IOU Proposal

Summary of Changes to October 5 Draft of Joint IOU Proposal

On November 1-2, 2011, the Commission held a Workshop to discuss the rate impact model and allowance revenue return proposals filed in this proceeding. At this Workshop, the Joint IOUs gave a presentation describing the Joint IOU Proposal and received useful feedback from the Commission staff and participating stakeholders. Below is a summary of the major changes made to the Joint IOU Proposal in response to that feedback.

1. **Definition of Equitable.** The ALJs requested that the Joint IOUs more clearly define the term "equitable" as used in this Joint IOU Proposal. Accordingly, in Section II.A, the Joint IOUs have defined "equitable" as including two components: adhering to cost-causation principles and avoidance of cross-subsidies. In Section III.B.2, the Joint IOUs have ranked this as a "Critical" objective because these equity principles have been espoused by the Commission in the ratesetting context and an inequitable approach will jeopardize the success of the cap-and-trade program. In Section V.B, the Joint IOUs explain that the Joint IOU Proposal, which does not create additional cross subsidies and adheres to cost-causation principles, achieves this policy objective.

2. **Customer Price Signal.** At the Workshop, ARB and Commission staff members raised the issue of whether or not commercial and industrial customers have a price signal embedded in rates. In Section III.B.VI(b), the Joint IOUs have explained that even though commercial and industrial customers' rates are not subject to tiering in the same way as residential rates, there is still a significant GHG component in the variable portion of their rates. Thus, the IOUs' existing commercial and industrial rates and revenue requirements already include a robust retail GHG price signal. The IOUs reiterate that given this existing pass-through of costs to these customers as well as inclusion of GHG costs in the revenue allocation process, proposals should not seek to create any additional price signals through the AB 32 cap-and-trade program.

Several stakeholders expressed confusion with respect to the Joint IOUs' argument that a price signal would be an expensive way to achieve emissions reductions. In Section III.B.VI(d), the Joint IOUs clarify that given price elasticity of demand for electricity, actually reducing GHG emissions to AB 32 prescribed levels through a retail-level price signal would cost between $375 to $3,000 per metric ton. While the Joint IOUs recognize that such a price signal is neither practical nor desirable, the Joint IOUs argue that the price signal currently being proposed will have very little conservation effect.

3. **AB 32 Costs.** The ALJs requested that the Joint IOUs provide justification for proposing an allowance revenue return that covers a portion of all AB 32 costs, rather than just the direct compliance costs of the cap-and-trade program. Accordingly, in Section IV.A.2(a), the Joint IOUs explain that it was the clear intent of the ARB in allocating allowances to the IOUs to compensate customers for early action and other emissions reduction measures approved by the ARB and taken to reduce GHG emissions prior to and during the AB 32 implementation period, including GHG-emissions reduction initiatives such as the RPS, CSI, CEE, and CHP. As further supporting evidence, in Section IV.A.2(b) and in Appendix C the Joint IOUs present a projection of the total cost of just two AB 32 programs (RPS and CSI) over the term of the cap-and-trade program. These costs in addition to projected direct cap and trade costs (which do not even reflect to total cost of AB 32 imposed on customers) will exceed the total value of allowances by approximately $20 billion, thereby justifying a 100 percent return of all allowance revenues to customers.

4. **Education and Outreach.** At the Workshop, several stakeholders and the ALJs expressed concern that the Joint IOU Proposal was not transparent. In Section IV.A.3 of the Joint IOU Proposal, the Joint IOUs have outlined a collaborative stakeholder process, beginning at the January 11 workshop for developing a customer outreach and education program. Through a targeted education and outreach program, the IOUs can inform customers about the goals and benefits of the cap-and-trade program and ways to mitigate longer-term cost impacts of AB 32 through existing conservation programs. Such a program would achieve the conservation

goals sought by “price signal” advocates, and at the same time help ensure that customers perceive AB 32 as a successful program for reducing GHG emissions and addressing climate change.